

UNANTICIPATED COSTS/FUNDING SHORTAGES

- **DEFINITION**

There are three common types of funding shortages that a department may encounter. Each deals with a lack or insufficiency, and takes on different forms, urgency, and remedies.

The three common types of shortages are:

- Shortage of cash in a fund.
- Shortage of expenditure authority due to timing of reimbursements (temporary cash flow problem).
- Shortage of appropriation authority due to unanticipated costs (expenditure authority). This is the most common type of funding shortage.

Each of these funding shortages is discussed separately in the following pages. General questions regarding unanticipated costs may be directed to the Cash Management Unit in the Department of Finance (Finance).

- **SHORTAGE OF CASH IN A FUND**

- **Background and Creation of a Cash Deficit**

The state's fiscal system revolves around the management of specific legal budgeting and accounting entities called funds. This is a big difference between government and the private sector. Even the largest private corporation is essentially void of a fund structure. Its financial accountability could be viewed in terms of a single fund entity with one set of financial statements, one balance sheet, and one profit and loss statement for each fiscal period.

The State of California has over 1,000 separate funds with statutory requirement to maintain accountability for revenues, expenditures, etc., for each fund. The General Fund is used to account for those transactions not identified to a specific fund.

A fund may experience a cash shortage due to decreased revenues, increased expenditures, timing problem, or a combination of them. When a fund's cash becomes exhausted, the Controller will not issue a warrant against the fund.

- **Remedies for Cash Shortages**

- Are there prior year adjustments to revenues or expenditures which can help? For example, can an agency pursue recovery from the federal

government for expenditures which were previously made from this state fund?

- Increase in taxes, licenses, fees, and/or other revenues.
- Can moneys be legally transferred from another fund?
- Can funds be borrowed internally from other state funds per Government Code 16351?
- Can administrative steps be taken to reduce expenditures or slow disbursements?
- Expedite the collection of receivables and reimbursements.
- **TEMPORARY SHORTAGE OF EXPENDITURE AUTHORITY (Temporary Cash Flow Problem)**

For appropriations with a significant level of scheduled reimbursements or payables (such as amounts payable from federal funds), there is always the potential for the "remaining appropriation" to become exhausted even though the program expenditure authorization may still be adequate. This situation is caused by the reimbursements or payables not being collected in a timely manner, thereby creating a cash flow problem for the main item.

The following table illustrates how an appropriation has reached this cash flow shortage situation.

Appropriation Schedule	Authorized	Expended To Date	Remaining Appropriation
Program A	200	150	50
Program B	100	70	30
Program C	100	80	20
Reimbursements	<u>-200</u>	<u>-100</u>	<u>-100</u>
Remaining Appropriation	200	200	0

Although this appropriation still has expenditure authority remaining for all of its programs, the Controller will not honor any additional expenditure as the overall remaining appropriation balance is zero.

Assuming that the remaining expenditure authority at the program level is adequate, the first option to solve this problem should be an effort to collect the budgeted reimbursements.

The next option would be to provide an augmentation in the form of a temporary loan to an "unallocated category" which would provide funds for the item without increasing program expenditure authority. The reason an "unallocated category" does not add expenditure authority is that the Controller will not charge expenditures to such a category.

The following table illustrates the condition of the same appropriation above after

an augmentation of \$100 to an "unallocated category". (Note: This type of augmentation is usually provided by an Executive Order issued by Finance.)

Appropriation Schedule	Authorized	Expended To Date	Remaining Appropriation
Program A	200	150	50
Program B	100	70	30
Program C	100	80	20
Unallocated	100	0	100
Reimbursements	<u>-200</u>	<u>-100</u>	<u>-100</u>
Remaining Appropriation	300	200	100

The augmentation could be from:

- Budget Act Item 9850-011-0001 which is a statewide item for loans,
- Special authorization such as that provided to the State Treasurer's Office (Budget Act Item 0950-001-0001, Provision 1), or
- Proposed legislation that would need to be enacted.
- **SHORTAGE OF APPROPRIATION AUTHORITY (Insufficient Spending Authority)**
- **Background**

While departments are required by the Government Code, Budget Act, and California Victim Compensation and Government Claims Board Rules to operate within their appropriations, sometimes unabsorbable unanticipated costs occur. Unanticipated cost requests are given close scrutiny by Finance and the Legislature. Generally, the unanticipated cost must be no fault of the department, cannot be absorbed by the department, and the department does not have other funding alternatives.

The Legislature has always recognized that the enacted budget is a point-in-time estimated plan and that the executive branch needs a process to provide for unforeseen funding needs.

Early Years

The Budget Act has traditionally included a General Fund appropriation (called the Emergency Fund in the early years) to provide deficiency funding. The amount was minimal and had to be augmented annually through enactment of an "omnibus deficiency bill." Special fund deficiencies were funded through the continuous appropriation provided in Government Code (GC) section 11006.

From the late 1970s through 2003

In addition to the General Fund, the Legislature included appropriations in the Budget Act to fund deficiencies from special funds and nongovernmental cost funds. These items had minimal funding and required augmentations through passage of an omnibus deficiency bill(s). Language in the items precluded the use of GC section 11006 for deficiencies. The deficiency items were coded with the Organization Code 9840, Augmentation for Contingencies or Emergencies, and the Governor's Budget included a summary informational presentation of the actual past year and estimated current year deficiencies under Organization Code 9840.

Prior to 2004-05, there was Control Section 27.00, Control Section 32.00, and Item 9840 that provided the basis for funding deficiencies. Control Section 32.00 allowed departments to spend at a rate to incur a deficiency if they first received permission from Finance whereas, Control Section 27.00 provided reporting requirements for deficiencies, defined allowable deficiencies, and allowed Finance to authorize a department to spend at a rate to incur a deficiency. Finance used the authority provided by Control Section 27.00 to augment deficient items as the language provided.

Beginning with the 2004-05 fiscal year

In 2004-05, GC sections 11006 and 13332.04, and Control Section 27.00, were repealed. Control Section 32.00 was concurrently revised to reflect the deletion of Control Section 27.00 and specifically the loss of Finance's authority to approve a department to spend at a rate to incur a deficiency.

Control Section 32.00 and GC section 13324 prohibit any expenditure that is in excess of appropriations (with the exception of appropriations made in the California Constitution and expenditures mandated by federal law) and provide that any person who incurs a cost in excess of the amount authorized in law can be held personally liable for the amount of the unlawful expenditure or indebtedness.

Departments must have legal authority to spend before incurring an obligation against the fund. Any department representative who has entered into a contract or obligated funds for unanticipated costs prior to a 9840/Supplemental Appropriations Bill (SAB) augmentation approval is in violation of Control Section 32.00 and may be held personally liable for costs incurred if the funding is not approved. Since the Administration does not control the timing of passage of SABs, units and departments need to be aware of the consequences of Control Section 32.00.

To help address potential funding problems because of the removal of Control Section 27.00, the Legislature increased the Budget Act appropriations for the 9840 items to \$50 million for General Fund (this amount has since been reduced

to \$20 million) and \$15 million each for special funds and nongovernmental cost funds. Unanticipated costs will be funded either by an allocation of the 9840 amounts or through the passage of a SAB.

Federal Funds

Prior to late 1970s, federal fund appropriations were generally not included in the Budget Act and spending was authorized through the continuous appropriation provided in GC section 16360. In the late 1970s, the Legislature started to include appropriations from federal funds in the Budget Act. The Legislature recognized there was a need for added flexibility because of a higher level of uncertainty regarding federal funding levels and has annually included Control Section 8.50 in the Budget Act. This section includes a statement of legislative intent to maximize federal funds and appropriates any additional unanticipated federal receipts that were not considered in the Budget Act. These federal funds are subject to Control Section 28.00 reporting requirements to the Joint Legislative Budget Committee (JLBC). Control Section 28.00 also requires notification to be sent to the Director of Finance within 45 days of receiving official notice of availability of additional, unanticipated federal funds or other funds from non-state entities. Although there is no time requirement on Finance, the expectation is for Finance to respond quickly upon receipt of the department's notification.

- **Limitations**

Requests for augmentations through an Item 9840 or SAB are limited to unanticipated costs incurred during the current fiscal year for an existing program.

This funding is not available for the following:

- Capital Outlay
- Expenses attributable to a prior fiscal year
- Expenses related to legislation enacted without an appropriation
- Startup costs of programs not yet authorized by the Legislature
- Costs the Administration had the knowledge of in time to include in the previous May Revision
- Costs the Administration has the discretion to incur or not incur

C. Operating Departments' Responsibility to Avoid Shortages

Control Section 32.00 of the Budget Act, California Victim Compensation and Government Claims Board Rule 614, and GC Section 13324 provide that state officers are expressly forbidden from making any expenditure in excess of their

appropriation. Any officer or employee who over expends an appropriation can be held personally liable for the amount of such unlawful indebtedness. Departments must inform Finance promptly as they become aware of a funding shortage situation. The Finance Form DF-580 plus any appropriate documentation are used for this reporting. Form DF-580 may be **viewed and printed using the Word reader**. Go to the [Finance Budget Forms](#) page on the Finance website and select the form. Any questions regarding completion of the form may be directed to the Finance Budget Analyst.

- **The Process for Funding of Unanticipated Costs**

Departments that have a critical unanticipated funding need that meets the criteria established in the 9840 items must first take all legally permissible steps to reduce expenditures and avoid a funding shortage. If the cost is unavoidable, departments must notify Finance immediately by submitting an “Unanticipated Cost Funding Request” Form DF-580. The information provided on the DF-580 must include a detailed explanation of what caused the need for additional funding, an explanation of what steps were taken to avoid a funding shortage, and the date the spending authority to obligate funds (not make a cash payment) will be needed.

Upon receipt of the funding request from the department, Finance must notify the JLBC within 15 days of the request for funding for unanticipated costs. Finance will review the request to determine the necessity of the request and to determine if the request is in accordance with the provisions of Item 9840.

After the decision is made to fund the unanticipated cost request, determination must be made to either fund the request through Item 9840 or through a SAB.

The determination of the funding method will be made based on:

- The timing of the request
- The fund from which the expenditures will occur
- The amount of funding required
- The balance available in the appropriate 9840 item (see the Cash Management Unit) and other pertinent data.

Finance analysts must obtain approval from the Capitol Office before unanticipated costs can be funded through the 9840 items.

Unanticipated Costs funded through an allocation from the 9840 items

After the decision has been made to fund unanticipated costs through the 9840

item, Finance will prepare a 30-day letter to the JLBC notifying them of the intent to fund the unanticipated costs through an allocation from a 9840 item. After the 30 days has elapsed, and if the JLBC does not object, Finance will prepare and submit a budget executive order to the State Controller's Office (SCO) to make the allocation.

Unanticipated Costs funded through a SAB

Finance will send a letter to the JLBC informing them of the concurrence with the funding request for unanticipated costs. The JLBC will find an author for the SAB and Finance will be the sponsor of the bill. Upon passage of the bill, the department's appropriation will be augmented with the funding contained in the bill. There is no need to prepare a budget executive order. The SAB requires the SCO to augment the items in the SAB. The Cash Management Unit usually notifies the SCO when the Governor signs the SAB.

While the goal is to provide funding in the current year when it is needed, there have been some years where the bill has not been signed until after the fiscal year has ended.

- **Unanticipated Costs for Capital Outlay**

Language was added to the former statewide Control Section 27.00 in 1996 and incorporated into Item 9840 provisions in the 2004-05 Budget Act that "No unanticipated costs authorization may be made under this section for any expenditure for capital outlay". This restriction does not hinder operations as unanticipated costs for capital outlay were not previously funded through the same process as other operational funding shortage situations.

Funding shortages for capital outlay are typically funded through Government Code sections which authorize reversions and augmentations of appropriations subject to approval of the Public Works Board. The most common of these authorities is GC section 16352 which provides a continuous appropriation from Special Funds for augmentation of deficient appropriations because of increased construction costs. Questions regarding capital outlay unanticipated costs should be directed to the Capital Outlay Unit in the Department of Finance.

- **AN ANALYTICAL PERSPECTIVE: IS FUNDING REALLY NECESSARY FOR AN UNANTICIPATED COST?**

Both the operating department and Finance have a responsibility to determine when there is an actual funding need. The Legislature and the Governor have an expectation that departments live within their budgeted resources. Departmental fiscal staff and Finance analysts should consider the following in their review/analysis of unanticipated costs.

- If there is a fund shortage or funding need, has the option of offsetting savings

been fully explored? The first question which should be raised is if the additional costs can be squeezed from existing budget resources. Departments always have the option of setting priorities for expenditures.

- If the problem is one of cash flow, can the department increase its effort to collect reimbursements or federal funds? If this has been a recurring problem, should language be provided in future Budget Acts or in continuous appropriations authorizing loans for temporary cash flow problems?
- If the funding shortage is a recurring problem because of unexpected caseload/workload increases, should there be special authorizations in the Budget Act (or in statute) similar to language provided for departments such as the Department of Social Services (CalWORKS) and the data centers?
- Is this a disaster-related unanticipated cost which would allow use of allocations through the authorization provided in GC section 8690.6?